

# ICPS newsletter

## Favourable business environment an essential condition for economic growth

*The Cabinet of Ministers of Ukraine has declared in its Action Plan that a key principle of its economic growth policy is to encourage entrepreneurial potential. The government should guarantee favourable business conditions through reducing the tax burden, reforming state regulation, and involving public business associations in the policymaking process. Participants of a seminar on "Changes in the Business Environment", conducted as a part of ICPS's "Ukraine's Future: Public Feedback on Reform Policy", discussed an action plan for the improvement of business conditions*

### New budget policy stimulates business activity

Today, the main objective of the Ukrainian government is to create appropriate conditions for economic growth, particularly through halting state interference in business activities.

Mr. Yuri Lysytsky, the Government Secretary, emphasised that the current government has already significantly limited state interference in enterprise operations. This tendency is continuing, resulting in an

evident improvement in the business environment in Ukraine.

For this year, it was planned that funding at the lowest level will be allocated through the state treasury. Mr. Lysytsky stated that next year, the government planned to continue the reduction of the consolidated budget to 23 percent of GDP, compared to 27 percent of GDP in 2000.

The dynamics of monetary budget revenues are evidence of an economic recovery in Ukraine. Enterprises are paying taxes and levies to the budget in cash only. Moreover,

budget revenues have increased by 20–25 percent compared to last year.

As the Ministry of Finance has limited public borrowing, lending interest rates have been falling. Mr. Lysytsky noted that practically the whole broad money gain has been redirected back to the real economy.

### Government non-interference promotes economic recovery

One of the main problems of business development is the inconsistency of current legislation. Mr. Hennadi Bilous, deputy head of the State Committee on Regulatory Policy and Entrepreneurship, emphasised that the adoption of ineffective, socially inconsidered regulation is caused by the lack of partner dialogue between the government, businesses, and public organisations and by the shortage of real mechanisms for feedback between the government and society. It results in increased costs of business, an expanded shadow economy, and lost confidence in the government. The existence of numerous illogical and unclear regulations "ensures" the expansion of corruption.

The Presidential Decree "On the main principles for public regulatory policy for business activity" dated January 22, 2000, is a very important measure. According to the decree, the State Committee on Entrepreneurship has designed methodological recommendations on developing justifications for draft regulations that provide for mandatory analysis of the effects of new regulations.

The regulatory system should ensure competition and contract enforcement, and eliminate entrepreneur dependence on public officials regarding decisions on business activities.

The introduction of effective market legislation will allow to business entities and the government to cut down expenses of complying with regulations, thus leading to increased competitiveness of Ukrainian products and an improved investment climate in our country.

### Ways of attracting credit resources for business development

Mr. Bohdan Rybak, director of the UkrBusinessConsulting company, presented several ways of attracting credit resources in order to develop private business:

**1. Targeted loans extended by the state through authorised funds, e.g., the Innovation Fund and the Business Development Fund.** The disadvantages of this option are unstable funding from the state budget (for borrowers) and the low level of loan repayment (for the state-creditor).

**2. Loans extended by Ukrainian banks from inner resource base.** The disadvantages are high interest rates, short credit terms (3–6 months), and that many borrowers lack the required liquid collateral.

**3. Loans extended by Ukrainian banks from the attracted EBRD and IBRD funds.** These credit lines present the lowest interest rate under conditions that the credit period does not exceed 5 years. Moreover, merchandise imports, purchased using money received through such credit lines, are exempted from VAT, export tariffs, and excise. The disadvantage of this option is that the majority of Ukrainian enterprises are not ready for the complex procedures of obtaining credits according to EBRD and IBRD terms.

**4. Loans extended by financial intermediaries (venture funds) or sectoral investors.** After the financial crisis in 1998, these potential creditors have taken a wait-and-see attitude and, like banks, are not inclined to finance projects starting from scratch.

**5. Loans extended by individuals.** These loans are provided from money circulating in the shadow economy. Credit terms are flexible and feasible for borrowers, as under the shadow economy the major values—the life of the borrower and his family—play the role of collateral. Contrary to banks and financial intermediaries, individual creditors are eager to join projects at the ground level, in order to gradually gain whole control of enterprises. Because legal credit systems are underdeveloped, shadow loans are very popular. This results in steadily larger parts of the economy becoming dependent on shadow capital.

## Tax initiatives will foster improvement of the business environment

Mr. Viktor Onyschenko, deputy head of the State Tax Administration of Ukraine, presented a set of initiatives focused on the improvement of the tax regime in Ukraine. These measures should result in simplifying tax administration, building partner relations between enterprises and tax bodies, and strengthening taxpayer profitability. The Tax Administration initiatives are the following:

- legally introduce a single fine at the level of 0.1–0.3 percent (tax debts accrued as of January 1, 2000 were 12 billion hryvnias, including 8 billion of unpaid fines);
- in 2001, write off all fines accrued as of February 1, 2000, and restructure the tax debts accrued as of January 1, 1999 for 2 years;
- increase the restrictive minimum level of sales operations per year that requires enterprises to be registered as value-added taxpayers;
- cancel tax inspection posts in enterprises producing ethanol and alcoholic beverages.

## Business associations should control the government

For the first time, the government made statements in its Action Plan that the major basis of economic growth is increasing business potential. However, in the opinion of Ms. Ksenia Liapina, coordinator of the analytical group at the Coordination and Analytical Center for Ukrainian Business Associations, only businesses through their civic associations can provide control of public policy implementation.

There have already been established several institutions apprising the government of the business viewpoint, including representatives for supporting entrepreneurship at the State Committee on Regulatory Policy and Entrepreneurship, the Board of Businessmen at the Cabinet of Ministers, and the Board of Business Associations at the Government Committee on Economic Development. These public organisations actively inform businesses about different draft laws, harmonise conflicting interests, and provide feedback between entrepreneurs and the government.

## Integration into EU will encourage the improvement of investment climate

Mr. Volodymyr Ihnaschenko, departmental director at the Ministry of Economy of Ukraine, noted that the "investment climate" category is not an independent issue—it is an integral component of a favourable business environment.

Every investor and businessman is interested in political and economic stability. After the presidential election and the formation of new government, important measures have

## Summarised public proposals, developed during group work, on improving the business environment

### Measures of public policy which encouraged the development of private business in Ukraine:

- the Presidential decree on deregulation;
- introduction of the simplified taxation system;
- decreased selective support to enterprises;
- introduction of transparent market mechanisms oriented to development of competition;
- creation of private owners in agriculture;
- prohibition of establishing extrabudgetary funds at government bodies;
- restructuring of enterprise tax debts.

### Measures of public policy which restrained the development of private business in Ukraine:

- adoption of legislation without participation of stakeholders;
- creation of special economic zones;
- privatisation was realised insufficiently and did not lead to the emergence of effective private owners;
- delayed VAT indemnity;
- preservation of planned fine revenues in the Law of Ukraine "On the State Budget for 2000";
- complication of terms for establishing new companies (control of owners).

### Impediments to implementing state policy on changing the business environment:

- pressure of local authorities;
- inconsistency between public policy and regional policy;
- conspiracy between the authorities and business;
- negative public perception of businesspeople;
- insufficient transparency of decision-making process;
- government bodies implementing business functions;
- inefficacy of the Verkhovna Rada in decision making;
- society lacks knowledge of transition economy particularities;
- insufficient activity of civic business associations.

### Instruments for implementing changes in the business climate in Ukraine:

- determining principles of regulatory policy;
- prohibiting the planning of fine revenues;
- simplifying tax legislation and decreasing administration costs;
- bringing criminal action against businessmen only in the case of deliberate falsification of accounts;
- reviewing the goals of tax policy and administration.

been implemented in Ukraine in order to achieve such stability. Obvious improvement of the business environment has become possible due to government steps towards the development of a competitive environment, i.e., prohibition of mutual debt offsets and cancellation of tax privileges. To ensure the attraction of foreign investment, the government also should simplify customs procedures and guarantee intellectual property rights.

Integration into the European Union is a clear priority for Ukraine. According to Mr. Ihnaschenko, the adaptation of Ukrainian legislation to EU standards is a key tool for improving the quality of legal support of business and investment activities in Ukraine. However, till now no system for harmonising Ukrainian legislation has been designed and no priority determined. At the same time, these priorities should involve legislative fixing of the "rules of the game" for businesses, i.e., the Civil Code, the Tax Code, and a law "On the judiciary".

Another government objective is to guarantee stable conditions for investment, pursuant to the laws of Ukraine "On product sharing" and "On concessions".

Stability and predictable performance results are the main prerequisites for investment inflows.

Jim Bown, a member of ICPS's Board of Directors and former head of the Ukrainian offices of BP Amoco, mentions four basic requirements for a favourable investment environment:

- *opportunity to do profitable business* (natural resources, labour force, market potential);
- *stability* (political alignment, clear and predictable legislation, coherent government strategy);
- *transparency* (same rules for all, non-discriminatory interpretations of legislation, equal contract enforcement);
- *confidence* (financial stability, adherence to world business standards, effective corporate governance). ■

*The public discussion on "Changes in the Business Environment" co-organised by the Secretariat of the Cabinet of Ministers and the Ministry of Economy of Ukraine, the Coordination and Analytical Center for Ukrainian Business Associations, and the International Centre for Policy Studies was held at ICPS on June 1, 2000.*

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